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IN THE

Supreme Court of the United States

OCTOBER TERM, 1963

No. 717

JOHN S. GORSUCH, *Petitioner*

v.

PROVIDENT SECURITY LIFE INSURANCE COMPANY,
Respondent

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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Petitioner prays for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit in the above-entitled case.

OPINIONS BELOW

The opinion of the district court is unreported. It is found in Appendix A, and at pages 38-41 of the record. The opinion of the court of appeals is reported at — F.2d —, and is found in Appendix B.

JURISDICTION

The judgment of the court of appeals was entered October 1, 1963 (App. B). The jurisdiction of this Court is invoked under 28 U. S. C. § 1254(1).

QUESTION PRESENTED

Whether the power of a state's legislature to establish pre-requisites to a valid merger of its domiciled corporations can be both eliminated and rewritten by the invocation of federal common law concepts by a court of appeals?

STATUTES INVOLVED

The statutory provisions involved, all of which are set forth in Appendix C, are:

Arizona Revised Statutes, Sec. 10-344(C).
Arizona Revised Statutes, Sec. 10-345(A).
Arizona Revised Statutes, Sec. 10-346.

STATEMENT

Petitioner, an Ohio stockholder of United Security Life, an Arizona life insurance corporation, filed two separate and distinct actions for the benefit of United. One was designed to recover United's assets while this action attempts to preserve its existence.

The first, a shareholder's derivative suit, sought the recovery from American Security Investment Company of $314,794.19 of United's cash, bonds, and mortgages unlawfully taken by American to "pay" for the latter's purchase of a 38.79 per cent controlling stock interest in United.

While such action was pending, American caused a United shareholders' meeting to be called at which it voted the 38,799.89 shares of United stock in favor of merging United into Provident Security Life Insurance Company. (R. 9, 39). Of the 100,000 shares of United stock outstanding, 75,723 voted in favor of the merger. (R. 9, Ex. 1). Excluding the 38,799.89

shares voted by proxies for American, the total vote in favor of the merger was 36,923.11 shares. If the total outstanding shares of United be deemed not to include American's 38,799.89 shares, then only 36,962.11 votes out of a total of 61,200.11 were in favor of the merger. Arizona Revised Statutes, Sec. 10-344(C) requires, as a condition precedent to a lawful merger, the favorable vote of two-thirds of the outstanding stock. Therefore, the United-Provident merger could only comply with the statute if the 38,799.89 share votes cast by American's proxies were valid.

Thereafter, the stockholder's derivative action was tried, and the district court found as fact that American had unlawfully taken $314,794.19 of United's cash, bonds, and mortgages as recited above. *Gorsuch* v. *United Security Life*, et al., Civil No. 2974, filed by the district court on June 21, 1960. Judgment was entered against American and thirteen individuals. (R. 40). American and eight of the individuals failed to appeal, and the judgments against them became final in 1960 and 1961.

The second suit filed by Petitioner on February 12, 1962, was the instant action. Jurisdiction was founded on 28 U. S. C. § 1332. This action challenged the validity of the United-Provident merger described above. Both parties filed motions for summary judgment, and District Judge George H. Boldt ruled that the challenged merger had failed to comply with Arizona's statutory pre-requisites for a lawful merger in four particulars. In so doing, the district court, sitting as a court of equity, completed the task of returning United to its financial and legal status just prior to the $ 314,794.19 raid by American. It had, in short,

restored United's property *and* its life which had been taken from it by American's actions.

The four grounds upon which the district court relied in ruling that the United-Provident merger had not complied with Arizona's statutory pre-requisites for a lawful merger were:

(1) American's acquisition of the 38,799.89 shares of United stock was improper and invalid, and therefore the two-thirds majority of the outstanding stock in favor of the merger required by Arizona Revised Statutes, Sec. 10-344(C) was lacking.

(2) American was not the record owner of the 38,799.89 shares of United stock on the date of the merger vote, and therefore its voting of such shares was invalid.

(3) Assuming a valid two-thirds favorable vote of the United stock, all of the assets of United did not vest in Provident as required by Arizona Revised Statutes, Sec. 10-346.

(4) Assuming a valid two-thirds favorable vote of the United stock, a condition precedent to a valid merger was not met in that no copy of the merger agreement was filed with the county recorder as required by Arizona Revised Statutes, Sec. 10-345(A):

The court of appeals reversed the district court holding that:

(1) American had such title as to allow it to validly vote the 38,799.89 shares of United stock for a merger, and no constructive trust could exist in United's favor so as to invalidate such a merger vote prior to a judicial declaration thereof.

(2) The fact that American was not the record owner of the 38,799.89 shares of United stock is overcome by Arizona Revised Statutes, Sec. 10-231(A)(1) providing that title to stock shares passes upon delivery of such shares endorsed in blank.

(3) The merger agreement "in substance" does not provide for the retention, by United, of assets which should have been transferred, and Arizona Revised Statutes, Sec. 10-345(A) was not violated.

(4) Assuming the merger was valid in all other respects, the failure to record the merger agreement is overcome because there was a "de facto" merger in 1959.

REASONS FOR GRANTING THE WRIT

The court of appeals refused to follow Arizona statutes which spell out the pre-requisites for a valid merger of Arizona corporations. In so doing it has decided an important question of state law (the requirements for validity of a merger) in conflict with state law, and has thereby taken from Arizona's legislature the power to establish pre-requisites before a merger can take place. Its decision violates both the spirit and the substance of *Erie R. Co.* v. *Tompkins*, 304 U. S. 64.

The issue here is important not only to United, which will be deprived of its corporate life if there is no review, but also to Arizona as well. The reason is that the four statutory requirements for a valid merger which were glossed over or rewritten or eliminated by the court of appeals were each intended to fulfill an important public need in the judgment of the Arizona legislature. Thus, the two-thirds favorable vote, needed

before a merger can occur, protects minority shareholders from a simple majority determined to merge the corporation for their own interests. The rule that one be the record owner of stock before being entitled to vote such stock is essential if other shareholders are to have sufficient notice to challenge invalidly issued shares and have meetings conducted in orderly fashion. The requirement that all assets and all liabilities vest in the surviving corporation is vital to the protection of creditors of the merged corporation. And the requirement that the merger agreement be recorded in the county recorder's office gives the public and creditors notice of the terms of the merger.

More specifically the court of appeals has vitiated Arizona's pre-requisites for a valid merger as follows:

1. There is no Arizona law holding that American's title to the 38,799.89 shares of United stock was sufficient, in a case where United's assets had been taken to "pay" for the stock, to allow it to vote such stock and thereby merge United out of existence. Nor has the court of appeals cited any. Instead it has said that American's title as against the sellers of the stock was good. But it is not the sellers who are complaining. It is a shareholder of United who seeks on United's behalf to have United's unlawful merger held void. Consequently, American's title as against Kelly, the seller, is not in issue. Also, there is no Arizona law in support of the court of appeals statement that a constructive trust in favor of United could not exist at the time of the vote on the merger unless there had been a judicial declaration thereof.

If the court of appeals' rule as to the validity of American's title is allowed to stand, then Arizona Re-

vised Statutes, Sec. 10-344(C) means very little. Why? Because all the minority shareholders desiring merger need do is buy more of the corporate stock, "pay" for it with the corporation's assets, and then vote such shares in favor of a merger.

2. In addition to ruling that the necessary two-thirds favorable vote did not exist because American's title to the stock was defective, having used $314,794.19 of United's money and mortgages to "pay" for it, the district court also held that the vote by American was invalid since it was not the record owner of the 38,799.89 shares of United stock. This has not been avoided by the court of appeals' statement that title to stock endorsed in blank is passed when delivery is effected. The necessity for record ownership in order to vote corporate stock rests on the need of adequate notice to the other shareholders and the corporation. Therefore, assuming arguendo that American was able to acquire good title as against the other shareholders and United when it used $314,794.19 of United's cash and mortgages to "pay" for its purchase of the 38,799.89 shares of United stock, such a conclusion does not obviate the requirement that it be the record owner of the stock in order to vote for a merger which terminates United's existence.

3. And Arizona Revised Statutes, Sec. 10-346, requiring that all assets of the merged corporation vest in the surviving corporation, and that the rights of creditors against the property shall be preserved unimpaired, has been negated. This is so because paragraph 11 of the merger agreement provides that consenting United shareholders *shall be entitled* to any recovery obtained as a result of Petitioner's $314,794.19 action on behalf of United. The court of appeals

ruled that "in substance it does not provide for the retention, by United, of assets which should have been transferred, but for the distribution, to consenting United stockholders, of the monetary value of a transferred asset of doubtful and unknown value, if it later developed that it had substantial value." But surely the fact that an asset is of unknown value at the time of a merger does not free it from the scope of the section. Also, it is beside the point to say the assets pass to the surviving corporation when the statute requires that it vest there. And how can the rights of creditors be preserved unimpaired when the court of appeals concedes that the paragraph does provide for "distribution" of the recovery to United shareholders consenting to the merger? Proof that the rights of creditors are impaired is shown by the court of appeals statement that they may have to litigate the matter later.

4. Arizona Revised Statutes, Sec. 10-345(A) requires that the merger agreement *shall* be recorded in the county recorder's office, and that when such recording takes place, the "consolidation shall *thereupon* be deemed consummated and the separate existence of the constituent corporations to have ceased, and the consolidated corporation *shall become* a single corporation. . ." That is, the merger is not consumated until such recording. The reason, of course, is to give the public notice. *Lewis* v. *State*, 32 Ariz. 182, 256, 1048, 1050. Here there was no recording of the merger agreement.[1] Yet the court of appeals has nullified this pro-

[1] Nor is the issue one of tardy recording. The district court's opinion herein was filed on March 28, 1962, and judgment was entered on May 15, 1962. (R. 41,44). The recording of which the court of appeals speaks occurred on May 23, 1962, and was presented in an avowal by Provident's counsel

vision, stating that there was a de facto merger.[2] But, as the court of appeals acknowledged, Arizona has no doctrine of de facto mergers.

The district court faithfully applied four of Arizona's statutory requirements for a valid merger. The court of appeals has nullified or negated each of the four. As a result, Arizona is the only state, known to Petitioner, where one can take $314,794.19 of a corporation's money to buy a controlling stock interest in that corporation, and then vote such stock to merge the corporation out of existence when sued for the $314,794.19. If such a rule were sanctioned by Arizona's legislature, it is doubtful that this Court would permit it to live under the Fourteenth Amendment. But here such a rule has been imposed upon Arizona by a court of appeals.

Arizona's statutory requirements for a valid merger show by their content and tenor that the Arizona legislature would not authorize the merger of two of its corporations underneath a bridge in the dark of night. Yet here the court of appeals, reversing the district court, has validated an attempted Arizona merger where there was no recording of the merger agreement with the county recorder, no vesting of all of the merged corporation's assets in the surviving corporation, no two-thirds favorable vote unless shares "paid" for with $314,794.19 of the merged corporation's money are counted, and no two-thirds favorable vote unless shares

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during the appeal. Thus, the recording occurred after the merger had been judicially declared void and invalid.

[2] Under the de facto doctrine, there is no statutory requirement for a valid merger which can remain alive in the face of an illegal merger which has existed for several years during litigation.

voted by one not the record owner of the stock are counted.

This is not simply a case where the court of appeals has erred. It is one wherein the power of a state to regulate and control the conditions for merging its corporations has been nullified. *Erie R. Co.* v. *Tompkins, supra,* was not just an academic statement of legal principle. It was a rule of law having force and content. But more than publication is required to impart force. The sure knowledge by lower courts that refusal to follow will result in review here is also necessary.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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APPENDIX A

UNITED STATES DISTRICT COURT FOR THE DISTRICT OF ARIZONA

Civil Action, No. 4046
Phoenix

JOHN S. GORSUCH, *Plaintiff*,

vs.

PROVIDENT SECURITY LIFE INSURANCE COMPANY, *Defendant.*

Memorandum Decision and Order Re Motions For Summary Judgment and Default

MEMORANDUM DECISION AND ORDER RE MOTIONS FOR SUMMARY JUDGMENT AND DEFAULT

This action challenging the validity of the United-Provident merger of 1959 was commenced following entry of the Court of Appeals opinion, 295 F.2d 909, in Cause No. 2974 of this Court, Gorsuch v. United Security Life. In that opinion the necessity of direct rather than collateral attack on the merger was indicated.

Both plaintiff and defendant have filed motions for summary judgment and plaintiff has filed a motion for default judgment based on defendant's failure to answer within the period prescribed by law. The motions have been submitted for decision on the record and written memoranda. Leave to present oral argu-

ment was extended but declined by counsel. From a review of the pleadings, affidavits and memoranda supporting the motions the following are shown as undisputed facts:

1. Approving votes of two-thirds of the issued stock of both United and Provident were required to authorize the merger. Only the vote of United stock is challenged, as to which: (a) American Security Investment Company by proxy voted 38,799.89 shares of United stock; (b) at the time of the vote ASIC was not the record owner of the stock which then stood in the name of Kelly; (c) on the United corporate record ASIC was not entitled to vote that stock and the vote thereof was invalid; (d) without valid vote of the Kelly stock the necessary two-thirds majority required for approval of the merger was not and could not be provided.

2. Assuming a valid vote of all United stock, the Arizona statutes relating to mergers were not complied with in that (a) the merger certificate agreement was not filed in the office of the county recorder of each county in which one of the constituent corporations at the time had its principal office as required by A.R.S. Sec. 10-345(A); (b) all assets of United did not pass to the consolidated corporation as required by A.R.S. Sec. 10-346.

3. The Kelly-ASIC stock transaction was ineffective by reason of improper and invalid acquisition of the assets of United by ASIC.

On the record there is no controversial issue as to any of the above stated facts. Item 1, in itself and standing alone, requires summary judgment as prayed for by plaintiff. The same is true as to item 2. These

items are established by unimpeached documents, uncontradicted affidavits and pleading admissions.

Item 3 above is established by the judgment against Kelly and others in Gorsuch v. United Security Life, supra, made final by dismissal of the appeals of those defendants. It will be further established by the judgment and additional findings and conclusions to be entered in the same cause.

For the reasons stated the summary judgment motion of plaintiff is hereby granted and the motion of defendant for summary judgment denied.

Plaintiff's motion for default is well taken on the basis of the cited authorities and as a matter within the discretion of the trial court. Accordingly, said motion is hereby granted.

To preserve the corporate status quo of Provident until the summary judgment above ordered becomes final on appeal or by failure of timely appeal, said judgment shall not become effective for any purpose, other than as to the status of Provident, United and their shareholders in cause #2974, supra, until further order of the court.

A form of summary judgment conforming to the foregoing rulings may be presented for signature and entry at the convenience of counsel.

Dated at Phoenix, Arizona, this 28th day of March, 1962.

/s/ GEO. H. BOLDT,
U.S. District Judge.

[Endorsed]: Filed March 28, 1962.

APPENDIX B

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 18,307
Oct. 1, 1968

PROVIDENT SECURITY LIFE INSURANCE COMPANY
Appellant,

vs.

JOHN S. GORSUCH, *Appellee*

Appeal from the United States District Court for the District of Arizona

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Before: BARNES, HAMLEY and JERTBERG, Circuit Judges

HAMLEY, Circuit Judge:

John S. Gorsuch, a stockholder in United Security Life (United), brought this action to have declared void a merger agreement entered into between United and Provident Security Life Insurance Company (Provident). District court jurisdiction is based on diversity of citizenship. Judgment was entered for plaintiff and defendant, Provident, appeals.

Gorsuch first attacked the validity of this merger during the course of the appeal to this court in *Niesz v. Gorsuch*, 9 Cir., 295 F.2d 909. That was a stockholder's derivative action in which Gorsuch, suing on behalf of United, sought to recover $314,794.19 for

the corporation from certain individuals all but one of whom were or had been stockholders, directors or officers of United.

After the complaint had been filed in that action, a merger was consummated whereby Provident was to continue in existence as the surviving corporation and United was to cease to exist. The derivative action nevertheless proceeded as if United continued in existence, Provident not being added as a party. After trial, the trial court, among other things, set aside, as inadequate, a verdict in the sum of $20,000 against certain defendants, and entered judgment in the sum of $314,794.19 against these and certain other defendants. In the alternative, the trial court determined that the jury verdict was advisory only, and entered findings of fact and conclusions of law supporting its judgment for plaintiff in the amount indicated.

In that case the trial court made no specific findings with reference to the merger, but did find and conclude that United was and is a corporation and citizen of and domiciled in the State of Arizona. On appeal the defendants in that case challenged this finding, contending that United was no longer in existence and that neither United nor Gorsuch had capacity to continue with the lawsuit.

In resisting this challenge, Gorsuch contended, on appeal, that the merger was not valid because American Security Investment Co. (American) which voted 38.79% of United stock in favor of the merger assertedly did not have good title to that stock. Rejecting that contention we held that American had prima facie title to the stock and that if Gorsuch wanted to contest the legality of the merger "he should have done

so in a direct action for that purpose." We further held that the merger was not subject to collateral attack in that action and that, for the purposes of that suit, the merger had been validly consummated, United having ceased to be a corporation.

These determinations led us to decide, without reaching the merits, that the judgment in the derivative action must be reversed because Gorsuch had lost his standing as a stockholder in United, and United had lost its capacity to be sued as a party defendant and its capacity as the real party in interest. The further proceedings which have since been had in that action are recounted in our decision therein, filed today, *sub nom. DePinto v. Provident Security Life Insurance Company*, No. 18245 in this court.

Gorsuch having been precluded by our decision, in *Niesz v. Gorsuch*, from challenging the validity of the merger in that action, instituted this direct and separate action on February 12, 1962. Specifically, he seeks a judicial declaration that the merger between United and Provident is void, and that United is a viable corporation still in existence. He also seeks an accounting on behalf of United of the moneys, assets and other property obtained from United in connection with the merger, together with all the income derived therefrom.

The cause came before the same district judge who acted in the derivative suit, both at the time of the initial judgment therein and in the further proceedings thereafter had.

In the course of the trial court proceedings both parties made a motion for summary judgment. Three days after plaintiff filed his motion for summary judgment, he filed a motion for judgment by default. This latter

motion was based on the ground that defendant had not filed an answer within the time prescribed by rule, nor at all, and had not filed any motion having the effect of extending the time for filing an answer.

The trial court thereafter filed a memorandum decision and order denying defendant's motion for summary judgment, granting plaintiff's like motion, and providing that a form of summary judgment conforming to the foregoing rulings might be presented for signature and entry. In this same decision and order the court also granted the motion for default.

A judgment denominated "Summary Judgment" was entered for Gorsuch and against Provident on May 15, 1962, this being the same date that judgment was entered for Provident in the further proceedings in the derivative action.

The court judicially declared that the merger was and remains null and void and that United is a viable corporation still in existence. Provident was ordered to account to United as prayed for in the complaint. The final decretal provision of this judgment is that ". . . the enforcement of said judgment shall be stayed until the further order of the Court."

Defendant moved to set aside the default, vacate the judgment, and grant a rehearing pursuant to Rules 59 and 60, Federal Rules of Civil Procedure. These motions were denied whereupon defendant appealed.

The questions first presented here have to do with the order granting the motoion for default.[1]

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[1] The parties have apparently regarded the judgment which was entered, despite its heading, as both a summary judgment and a judgment by default.

The complaint was filed on February 12, 1962, and, according to plaintiff's motion for default, the summons and complaint were duly served upon defendant on the same day.[2] Under Rule 12(a), Federal Rules of Civil Procedure, a defendant, other than the United States or an officer or agency thereof, is required to serve his answer within twenty days after the service of the summons and complaint upon him unless the court directs otherwise pursuant to Rule 4 (e), and except where this period is altered by the service of a motion permitted under Rule 12.

The trial court did not, pursuant to Rule 4(e) specify a different period within which the answer should be served. It follows that the answer should have been served by March 5, 1962,[3] unless the period for serving the answer was extended by serving, before March 5, 1962, a motion permitted under Rule 12. No answer had been served by March 19, 1962 when the motion for judgment by default was filed.

A motion denominated motion for summary judgment was filed on March 5, 1962, and was presumably served on the same date. Plaintiff argues that a motion for summary judgment is not a motion "permitted" under Rule 12, and therefore the service of that motion did not extend the time for serving the answer beyond March 5, 1962.

Defendant apparently accepts plaintiff's assertion that a motion for summary judgment is not "per-

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[2] Proof of service was not filed in the case. Defendant, however, made no point of this deficiency in the trial court, apparently accepting plaintiff's allegations as to the time when the summons and complaint were filed.

[3] The twentieth day fell on Sunday, March 4, 1962.

mitted" by Rule 12. It argues, however, that the motion which was served, despite its heading, was actually a motion to dismiss for failure of the complaint to state a claim, and was therefore "permitted" under Rule 12(b). Defendant argues, alternatively, that if the serving of the described motion did not extend the time for serving the answer, the denial of its motion to set aside the default was, in any event, an abuse of discretion.

The district court may, pursuant to Rules 55(c) and 60(b), Federal Rules of Civil Procedure, and for good cause shown, set aside a judgment by default. The disposition of a motion to set aside a default judgment is a matter which lies largely within the discretion of the district court. *Hiern v. St. Paul-Mercury Indem. Co.*, 5 Cir., 262 F.2d 526, 530. An abuse of discretion in denying such a motion is not shown unless the district court was clearly wrong in finding that good cause had not been shown for the motion to set aside the default judgment. See *Ferraro v. Arthur M. Rosenberg Co.*, 2 Cir., 156 F.2d 212, 214.

The cause here shown by defendant in support of its motion to set aside the default judgment was that: (1) before the expiration of the period within which an answer could have been timely filed, defendant appeared, and served and filed a timely motion for summary judgment; (2) the motion was not frivolous, but raised substantial questions which, if decided in defendant's favor, would have warranted judgment in its favor, thereby obviating the need of an answer; (3) defendant, in good faith although perhaps erroneously, believed that such motion was a "permitted" motion under Rule 12, thereby extending the time for serving an answer; (4) plaintiff was not prejudiced by the

failure to serve an answer because plaintiff had himself filed a motion for summary judgment without awaiting the service of an answer or action on his motion for default, and the district court had granted such motion; (5) defendant's answer, lodged with its motion to set aside the default judgment, tendered additional substantial defenses, including laches and the statute of limitations, not advanced in its motion for summary judgment.

In our opinion the district court was clearly wrong in finding, in effect, that these circumstances do not constitute good cause for setting aside the judgment by default on the ground of excusable neglect. See Rule 60(b)(1), Federal Rules of Civil Procedure. We are of the view that the showing here made for opening the default was substantially stronger than that which was made in *Barber v. Turberville*, D.C. Cir., 218 F.2d 34, in which an order denying a motion to open a default was reversed.

Denial of appellant's motion to open the default was therefore an abuse of discretion. It follows that the judgment under review is not sustainable on the basis of the default judgment.[1]

The remaining specifications of error pertain to the summary judgment aspect of the decision under review.

In the memorandum decision and order granting the motion for summary judgment the trial court stated

[1] It is therefore unnecessary for us to decide whether the motion, designated motion for summary judgment, was a "permitted" motion under Rule 12(b), thereby extending the time for service of an answer.

four reasons for granting that relief. The first of these is that less than the required two-thirds of the stockholders of United approved the merger. This is true, the court held, because 38,799.89 of the approving votes of United stockholders were voted for American Security Investment Company (American), and at that time American was not the record owner of those shares.

The factual basis for this holding is to be found in the affidavit of Vernon E. Niesz, which is attached to plaintiff's district court memorandum in opposition to defendant's motion for summary judgment. In this affidavit, allegations are made to the effect that American came into possession of 38,799.89 shares of United stock on or about October 17, 1957; that the ownership of these shares was never registered in the name of American in the stock register book or any other book or record of United; and that American was never the record owner of any shares of stock in United.

Copies of the stock certificates, on the basis of which American voted most of these 38,799.89 shares of United by proxy, are attached to the Niesx affidavit. On the face of each the name, James E. Kelly, J. E. Kelly, or United Family Guild, appears as the registered owner. The assignment form on the back of each such certificate is endorsed in blank by the registered owner, neither American nor any other name appearing therein as transferee.

Defendant argues that this ground for granting summary judgment is without merit because, under Arizona law, title to a stock certificate may be transferred by delivery of the certificate endorsed either in blank or to a specific person by the person appearing in the

certificate to be the owner, it being unnecessary to the effectuation of such transfer that the shares be transferred on the books of the company. Plaintiff makes no response to this argument.

In 1943, Arizona adopted the Uniform Stock Transfer Act. Chapter 56, Laws of 1943. The relevant part of section 3 of that chapter, A.R.S. § 10-231, is quoted in the margin.[5] It is specifically provided in this section that delivery of a stock certificate, endorsed in blank by the person appearing by the certificate to be the owner, as accomplished here, is sufficient to pass title, notwithstanding any provisions of the articles of incorporation, by-laws, or the certificate itself, providing for a different method of transfer.

It follows that it was error to grant summary judgment upon the ground that the merger is void because American was not the "record" owner of the shares of United which were voted for in favor of the merger.

The second reason stated in the trial court's memorandum decision and order why summary judgment should be granted is that a certified copy of the merger agreement was not recorded in the office of the county recorder of each county in which one of the constituent corporations at the time had its principal office, as required by the statutes of Arizona.

[5] "Sec. 10-231. *Transfer of certificate shares*

"A. Title to a certificate and to the shares represented thereby can be transferred only:

"1. By delivery of the certificate endorsed either in blank or to a specified person by the person appearing by the certificate to be the owner of the shares represented thereby.

"2. * * * * *

[Footnotes 6 and 7 on Page 13a]

The factual basis for this holding is to be found in the affidavits of N. C. Kelly Moore, the county recorder of Maricopa County, Arizona, and of Nola McLane, one of the attorneys for plaintiff. These affidavits are attached to plaintiff's memorandum in opposition to defendant's motion for summary judgment.

Defendant concedes that a certified copy of the merger agreement was not recorded in the office of the county recorder prior to the commencement of this action.[8] However, defendant argues in effect, the merger is in all other respects valid and, this being the case, tardy compliance with the statute in question

"B. The provisions of this section shall be applicable although the charter or articles of incorporation issuing the certificate, and the certificate itself provide that the shares represented thereby shall be transferable only on the books of the corporation or shall be registered by a registrar or transferred by a transfer agent."

[8] If the corporation had not obtained notice of the negotiation of the stock certificates, it would have been entitled to treat the registered owner as the true owner for dividend and voting purposes. But here the transferee gave notice of the transfer by exercising its voting rights. Cf. *Turnbull v. Longacre Bank*, 249 N.Y. 159, 163 N.E. 135, 138 (construing Uniform Stock Transfer Act).

[9] The Arizona statute in question is A.R.S. § 10-345A, which reads as follows:

"*10-345. Formal requirements for consolidation*

"A. If an agreement for consolidation, ratified and certified by each constituent corporation as provided in § 10-344, provides that one of the constituent corporations shall be continued as the consolidate corporation, the certified agreement shall be filed in the office of the

[Footnotes 8 and 9 on Page 14a]

left at least a de facto merger, and such a merger is not subject to attack by a nonconsenting shareholder.

Plaintiff of course challenges the assertion that the merger is valid in all other respects. But for the purpose of discussing this point we will assume that it is. If the merger is fatally defective on some other ground, it may be set aside on that ground, without regard to the tardy recording of a certified copy of the merger agreement.

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corporation commission, and one copy thereof, certified by the corporation commission, shall be recorded in the office of the county recorder of each county in which one of the constituent corporations has its principal office. The consolidation shall thereupon be deemed consumated and the separate existence of the constituent corporations to have ceased, and the consolidated corporation shall become a single corporation in accordance with the agreement, under its articles and name, possessing all powers and subject to all restrictions and disabilities of corporations organized for profit.

[8] According to these affidavits, no certified copy, nor any copy, of the merger agreement had been recorded in the office of the county recorder of Maricopa County as of March 19, 1962.

[9] Defendant asserts that a certified copy of the agreement was recorded in that office on May 23, 1952. It did not, by affidavit or documentary evidence, establish the fact that a certified copy of the merger agreement was so recorded. However, in its memorandum in support of motion to set aside default and vacate judgment, this representation was made, the docket and page of such recording being given. Plaintiff did not dispute this assertion in his answering memorandum, and does not dispute it on this appeal.

There seems to be no Arizona court decision dealing with de facto mergers. But Arizona recognizes the doctrine of de facto corporations in general,[10] and the rules pertaining thereto also apply to de facto consolidations and mergers. 15 Fletcher Cyclopedia Corporations, Perm. Ed., § 7155, p. 249.

As stated by that writer, if there is valid legislative authority for a consolidation, an attempt in good faith to consolidate under the statute, a colorable compliance with the statute, and the exercise or assumption of powers as a consolidated corporation, "the new or consolidated corporation is a corporation de facto, and, as a general rule, its corporate existence can only be attacked by the state, and in a direct proceeding." *(Id.)*[11] We cite, in the margin, several specific instances in which a consolidation or merger was held to have de facto status notwithstanding failure to comply, or tardy compliance, with a procedural statute.[12]

Both United and Provident have been proceeding since April, 1959, when the merger agreement was approved by the stockholders of Provident, as if a merger had been effectuated. The life insurance policies issued by United were taken over and have ever since been serviced by Provident. According to defendants, since that date all legal claims of United's former policyholders were and have been satisfied.

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[10] See *Rice v. Sanger Bros.*, 27 Ariz. 19-21, 229 P. 397, 399; *Sawyer v. Pabst Brewing Co.*, 22 Ariz. 384, 198 Pac. 118, 120. General decisional law with regard to the de facto status of incorporation where there has been a failure to file according to the relevant statute, is reviewed in 37 A.L.R. 1319; 22 A.L.R. 376 (annotations).

[Footnotes 11 and 12 on Page 16a]

On the assumption that the merger is valid in other respects we hold that, despite the tardy compliance with A.R.S. § 10-345A, a de facto merger came into existence in April, 1959, and, as such, it is not subject to attack by an unconsenting stockholder on the ground of such tardy compliance.

Plaintiff argues that even if the tardy recording of a certified copy of the agreement does not void the merger by operation of the Arizona statutes, it nevertheless constitutes a breach of the merger agreement. Plaintiff refers to provisions of the contract whereby the two companies agree to merger "pursuant" to the provisions of A.R.S. §§ et seq., and 20-731. Reference is also made to a provision of the agreement providing that, after execution of the agreement, "Provident shall thereupon forthwith file a certified copy of the agreement of consolidation pursuant to Section 10-345, A.R.S., and the consolidation shall thereupon be deemed consummated."

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[11] Strictly speaking, the transaction involved in our case is a merger rather than a consolidation. A consolidation contemplates the organization of a new corporation while a merger results in the survival of an existing corporation which has absorbed one or more others. See 15 Fletcher Cyclopedia Corporation, Perm Ed. § 7041, pp. 6-10. But with regard to the de facto doctrine the courts draw no distinction between consolidations and mergers. We also note that the applicable Arizona statutes (A.R.S. §§ 10-341 - 349) are contained in Article 11 of Chapter 1 of the General Corporation Law, the article being entitled "Consolidation or Merger."

[12] *Helvering v. Metropolitan Edison Co.*, 306 U.S. 522, 529; *Leavenworth County Comm'rs v. Chicago, R. I. & Pac. Ry.*, 134 U.S. 688, 698, 702; *Alabama Fid. Mortgage & Bond Co. v. Dubberly*, 198 Ala. 545, 73 So. 911.

Under our holding that notwithstanding tardy recording of a certified copy of this agreement a de facto merger was consummated (which, in this particular, has become de jure by the subsequent recording), we do not regard such tardiness as a substantial breach of the merger agreement.

The trial court therefore erred in granting summary judgment upon the ground that a certified copy of the merger agreement was not recorded in the office of the appropriate county recorder.

The third reason stated in the district court's memorandum decision and order why summary judgment should be granted has reference to the provisions of paragraph 11 of the merger agreement. This paragraph relates to the disposition of monies which Provident may receive as a result of the derivative action which was then, and still is, pending. It is therein provided that the stockholders of United who have surrendered their shares in that company pursuant to the merger agreement for shares in Provident shall be entitled to the net proceeds, if any, of such litigation, as set out in certificates of contingent interest to be issued to each.

In the certificates of contingent interest it is provided that there shall be deducted from any such net proceeds any recovery against Provident on possible claims which may be asserted against United which are not provided for in the merger agreement. The net sum available after such deductions, if any, would then be distributed to the holders of the certificates of contingent interest in proportion to their respective interests.

The district court held that, by reason of this pro-

vision of the merger agreement, all of the assets did not pass to Provident, as required by A.R.S. § 10-346.[13]

Defendant argues, in effect, that in so ruling the trial court misinterpreted the merger agreement considered in the setting in which it was made.

It is provided in section 7 of the merger agreement that, upon completion of the merger, all of the property and assets of every kind and nature of United shall become the property and assets of Provident. This included the interest of United in the derivative action then pending which Gorsuch had brought for the benefit of United against United and other defendants.[14]

In determining what representation the consenting stockholders should receive in Provident in exchange for their surrender of United stock, it was necessary to determine the net value of all United assets being transferred to Provident. But the derivative action had not yet gone to trial,[15] and the parties to the

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[13] A.R.S. § 10-346 reads:

"*10-346. Transfer of assets and liabilities*

"All debts due to, and all property and assets of, each corporation consolidated as provided in this article shall vest in the consolidated corporation, but rights of creditors against and liens on the property of each corporation consolidated shall be preserved unimpaired. The debts, liabilities and duties of the corporations consolidated shall pass to the consolidated corporation, and may be enforced against it in the same manner and to the same extent as if incurred or contracted by; or imposed upon it."

[14] The derivative action was commenced on November 4, 1958. The merger agreement is dated February 7, 1959. It was executed for United in March, 1959, and from Provident in April, 1959.

[15] The trial therein commenced on March 9, 1960.

merger agreement had no way of knowing whether United's interest therein would have any value, and if so, how much.

Being thus unable to fix a value on this asset, it was apparently decided to regard it as having no value insofar as the merger was concerned. Thus, no Provident stock was issued to United stockholders on the basis of any value being attributed to United's interest in the derivative action. To make certain of this, paragraph 8(c) of the merger agreement provides for the cancellation of 38,798 shares of the stock of United then held in the name of American. It was in connection with the purchase of this stock from James E. Kelly and United Family Guild organized by some of the defendants in the derivative action, that the asserted depletion of United assets occurred which is at the foundation of the derivative action.

The parties to the merger also apparently recognized that, although no value could then be fixed for United's interest in the derivative action, it might turn out that Provident, as the successor to United's interest, would receive some monetary recovery therefrom. It was also realized that Provident, as the successor to United, might be held liable on some claim which might exist against United, of which the parties were then unaware, and could not have taken into account in determining the net value of the transferred assets.

Paragraph 11 of the merger agreement was evidently designed to meet these future contingencies. In substance it does not provide for the retention, by United, of assets which should have been transferred, but for the distribution, to consenting United stock-

holders, of the monetary value of a transferred asset of doubtful and unknown value, if it later developed that it had substantial value.

So viewed we do not regard the paragraph 11 provision as a violation of A.R.S. § 10-346, for United's interest in the derivative action was transferred to and vested in Provident. If there is anything wrong with the arrangement it is the possible future depletion of Provident's assets after the merger, accomplished by honoring the commitment, under paragraph 11, to distribute the net proceeds of the derivative action, less certain deductions, to consenting stockholders of United. It may be found that such a depletion would violate applicable law governing the distribution of dividends and the liquidation of corporate assets.

But no such distrbution may ever occur, for there may never be any such proceeds. If it later develops that there are net proceeds after the indicated deductions available for distribution under paragraph 11, then will be the time and occasion to test the validity of the arrangement. That litigation, if it proves necessary, will provide an opportunity for the consenting stockholders of United who now hold Provident stock, the other stockholders of Provident, the policyholders of Provident, and others who may be adversely affected by that adjudication, to have their day in court. None of them, save Gorsuch in the first of these categories, is before us in this action.

Any such suit will not, however, affect the validity of this merger, but only of paragraph 11 of the merger agreement.[16] All that will be involved will be the

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[16] This, in essence, is the position stated by defendant in its reply brief here, where it states:

legality of such a distribution by Provident. There may, of course, be equitable aspects to such a case. The consenting stockholders of United may be able to establish that they should at least be entitled to receive additional Provident stock equal to the net value of such proceeds. Otherwise, it might be contended, Provident would have what turned out to be a valuable asset of United for which it did not credit those stockholders in the initial allotment of Provident stock. But these are not problems which concern us here.

The conclusion which we reach concerning this problem finds support in the official action taken by the Arizona Director of Insurance in approving the merger agreement. We do not agree with defendant that this official action is conclusive and binding on the courts on the question of the validity of the merger. But we think it is entitled to respect and weight in a judicial determination of that question.

Under A.R.S. § 20-731, no merger or consolidation of domestic stock insurers may be effectuated in Arizona unless the plan and agreement have been filed with and approved in writing by the Director.[17] The Di-

"As to the argument of appellee that 'all assets did not vest in Provident,' it appears that the very statute cited by him has the effect of nullifying his argument. As he says (Appellee's brief, page 11), § 10-346 A.R.S. expressly provides that all debts and all property and all assets of each corporation shall vest in the consolidated corporation. If this statute has any meaning or force whatsoever, it means that regardless of what might appear in a merger agreement, the statutory provisions would prevail."

[17] A.R.S. § 20-731(B) reads:

rector is precluded by that statute from giving his approval if he finds the plan or agreement to be contrary to law. The Director not only approved the merger agreement,[18] but actively worked toward its consummation.[19]

"*20-731. Merger or consolidation of stock insurers*

* * * * *

"*B.* No such merger or consolidation shall be effectuated unless in advance thereof the plan and agreement therefor have been filed with and approved in writing by the director of insurance. The director shall give his approval within a reasonable time after filing unless he finds the plan or agreement:

"1. Is contrary to law.

"2. Inequitable to the stockholders of any domestic insurer involved.

"3. Would substantially reduce the security of and service to be rendered to policyholders of the domestic insurer in this state or elsewhere."

[18] The approval is as follows:

"APPROVAL:

"The foregoing merger agreement between United Security Life the ceding company, & *Provident Security Life Insurance Company*, the reinsurer, having been presented and filed with the Insurance Department in Arizona, is hereby approved.

"Dated this 26th day of February, 1959.

"s/ G. A. Bushnell
"George A. Bushnell
"Director of Insurance
"State of Arizona"

[19] This is evidenced by the Director's letter of February 7, 1959, appended to one of the affidavits of record, which reads in part:

"Plans have been formulated whereby the United Security Life Insurance Company . . . will merge into the Provident Security Life Insurance Company, an old line legal reserve life insurance company, with the result that

It follows that the approval which the Director gave to this merger agreement represents the official judgment and ruling of the state agency charged with the responsibility of protecting the public interest with regard to the merger of insurers, that there was no failure to comply with A.R.S. § 10-346.

In *Niesz v. Gorsuch*, 9 Cir., 295 F.2d 909, 912, we took the Director's then-assumed approval into consideration in determining that the merger was prima facie valid, and would be regarded as valid for the purposes of that case. Likewise, we here take that now factually-established official state action into consideration. In our view it lends substantial support to our conclusion that the merger is not invalid by reason of failure to comply with A.R.S. § 10-346.

Defendant argues that not only was there a failure to Provident to assume all of the assets of United, but also a failure to assume all of its liabilities, as required by A.R.S. § 10-346.

This was not one of the grounds on which the district court relied in granting summary judgment. Defendant's argument turns, in part, on inferences it draws from paragraph 8 of the merger agreement, an exhibit attached to that agreement, and paragraph 3 of the form of certificate of contingent interest. We have

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the policyholders' surplus will be in the approximate amount of one-half million dollars, a substantial over-all margin for contingencies.

"Our purpose in working out a plan of merger other than the process of liquidation has been to preserve the policyholders' equity and to safeguard the interest of all the policyholders . . . and we feel that the present plan of merger is the means by which the policyholders' equity will be safeguarded and without loss to any of the United Security Life policyholders."

examined these materials and are of the view, as apparently was the district court, that this contention is without merit.

The fourth and final reason stated in the district court's memorandum decision and order why summary judgment should be granted is that the transaction by which American came into possession of the United stock which it voted in favor of the merger was improper and invalid.[20]

American did not purchase its 38.79% stock interest in United from United. It purchased the bulk of this stock, consisting of 35.14% of the outstanding stock of United from James E. Kelly, who had been the controlling shareholder, president and a director of United. It purchased the remainder, consisting of 3.65% of the outstanding stock of United from United Family Guild, another corporation controlled by Kelly. There is accordingly no contention that the stock was fraudulently issued by United. Nor is it contended that Kelly and United Family Guild were not the rightful owners of this stock.

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[20] The court thus accepted, as one ground for the summary judgment, the only ground specifically alleged in the complaint. As set forth in paragraph 7 of that pleading, this ground is:

> "7. The merger agreement, referred to in paragraph 5 above, and steps taken pursuant thereto by defendant were null and void for the reason that the requirements of Arizona law were not met in that two-thirds of the outstanding stock did not legally consent to the merger for the reason that 38.79% of the stock voting for the merger was unlawfully held and voted by American Security Investment Company which unlawfully used $314,794.19 of United Security Life's assets to 'pay' for the 38.79% of United Security Stock and therefore did not have good title thereto."

But it was Gorsuch's contention in *Gorsuch v. United Security Life*, and it is his contention here, that Kelly and those who incorporated American, paid Kelly and United Family Guild for this stock largely with assets unlawfully taken from United. According to Gorsuch, the method utilized in accomplishing this diversion of United's assets, was for American to sell to United 30,800 of the former's assertedly worthless shares, for $308,000 in the assets of United. These latter assets were then transferred by American to Kelly in payment for Kelly's stock in United.[21]

As a factual basis for the essential allegation that American had unlawfully taken $314,794.19 of the liquid assets of United to pay Kelly for the purchase of United stock from him, plaintiff referred to findings of fact Nos. 15-20 in the case of *Gorsuch v. United Security Life*, and the certified transcript of record in that case.

Defendant contends that if there was an unlawful diversion of the assets of United to American so that the latter could buy United stock lawfully held by Kelly and United Family Guild, this would not undermine American's title to that stock in such manner as to render of no effect the voting of that stock by American in favor of the merger proposal. Accordingly, defendant argues, summary judgment for plaintiff should not have been entered on the ground that this transaction invalidated the merger.[22]

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[21] According to Gorsuch, $6,794.19 of United cash was also transferred to American which, with the $308,000 in United property, comprised the $314,794.19 referred to in the complaint.

[22] Defendent also argues that this matter should not have been disposed of by summary judgment because it had, by

Any impropriety in the transfer of assets from United to American could not affect American's right to that stock as against Kelly and United Family Guild, the lawful owners of that stock prior to the transfer. This is true because Kelly and United Family Guild were participants in the transaction and received the fruits of the transfer in the form of payment for their stock in United.[23]

It may well be that the United stock held by American as a result of that transaction was subject to a constructive trust in favor of United by reason of the asserted fraud. But no such constructive trust had been declared at the time the stock was voted for the merger proposal by American. Since then this stock has been cancelled pursuant to the merger agreement.

Plaintiff cites no authority in support of the proposition that amenability of issued stock to the imposition of a constructive trust on behalf of the corporation precludes a valid voting of the stock even prior to a judicial declaration of such a trust. All corporate transactions involving the vote of stockholders would be subject to intolerable uncertainty if the validity

affidavit, created a genuine issue of material fact as to this matter. Plaintiff disputes this contention and also argues that the facts, even if now denied by defendant, are established against it under principles of res judicata, by reason of the findings entered in the *Gorsuch v. United Security Life* suit.

[23] In any event, it is the transferor of the stock, and not the issuing corporation, who may complain and take action concerning a stock transfer which is defective in any respect. 12 Fletcher Cyc. Corp. §§ 5529, 5530, pp. 598, 600. Neither Kelly nor United Family Guild has made any complaint against American in connection with the transaction.

thereof could later be challenged on grounds of this kind.

We hold that, assuming all of the circumstances to be as asserted by plaintiff, American nevertheless had such title to Kelly's lawfully issued United stock as enabled it to validly vote such stock in favor of the merger proposal.[24]

It is our conclusion, for the reasons stated above, that the judgment for plaintiff is not sustainable on any of the grounds relied upon by the district court, nor upon the additional ground, not relied upon by that court, that there was a failure of Provident to assume all of the liabilities of United. It therefore becomes unnecessary to explore the various other reasons advanced by defendant why summary judgment should have been entered in its favor. There was no cross appeal.

The judgment is reversed and the cause is remanded for further proceedings consistent with this opinion.

(Endorsed) : Opinion Filed Oct. 1, 1963.

Frank H. Schmid, Clerk.

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[24] Our disposition of this question makes it unnecessary to decide whether the granting of summary judgment on this ground was precluded by the presence of a genuine issue of material fact.

[25] Among these are the following: (1) Plaintiff is concluded from questioning the validity of the merger because of the decision of this court in *Weiss v. Gorsuch*, 9 Cir., 295 F.2d 909; (2) Plaintiff is concluded by the original district court decision rendered in that litigation from questioning the validity of the merger; and (3) To hold the merger invalid would be totally inconsistent with the judgment entered in 1962 in the derivative action.

JUDGMENT

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 18,307

PROVIDENT SECURITY LIFE INSURANCE COMPANY, *Appellant*,

vs.

JOHN S. GORSUCH, *Appellee*.

APPEAL from the United States District Court for the District of Arizona.

THIS CAUSE came on to be heard on the Transcript of the Record from the United States District Court for the District of Arizona and was duly submitted.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court, that the judgment of the said District Court in this Cause be, and hereby is reversed with costs in favor of the appellant and against appellee and that this cause be and hereby is remanded to the said district court for further proceedings consistent with the opinion of this Court.

It is further ordered and adjudged that appellant recover against appellee for its costs herein expended and have execution therefor.

Filed and entered October 1, 1963.

APPENDIX C

Arizona Revised Statutes, Sec. 10-344(C)

"If two thirds of the stock, valued as provided by this section, is voted in favor of consolidation, the agreement shall be declared adopted and the vote certified on the agreement by the secretary of the corporation so voting. The agreement shall be signed and acknowledged by the president and secretary of the corporation, and its seal affixed thereto."

Arizona Revised Statutes, Sec. 10-345(A)

"If an agreement for consolidation, ratified and certified by each constituent corporation as provided in § 10-344, provides that one of the constituent corporations shall be continued as the consolidated corporation, the certified agreement shall be filed in the office of the corporation commission, and one copy thereof, certified by the corporation commission, shall be recorded in the office of the county recorder of each county in which one of the constituent corporations has its principal office. The consolidation shall thereupon be deemed consummated and the separate existence of the constituent corporations to have ceased, and the consolidated corporation shall become a single corporation in accordance with the agreement, under its articles and name possessing all powers and subject to all restrictions and disabilities of corporations organized for profit."

Arizona Revised Statutes, Sec. 10-346

"All debts due to, and all property and assets of, each corporation consolidated as provided in this article

shall vest in the consolidated corporation, but rights of creditors against and liens on the property of each corporation consolidated shall be preserved unimpaired. The debts, liabilities and duties of the corporations consolidated shall pass to the consolidated corporation, and may be enforced against it in the same manner and to the same extent as if incurred or contracted by, or imposed upon it."

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In the Supreme Court of the United States

OCTOBER TERM, 1963

No. 717

JOHN S. GORSUCH, *Petitioner,*

vs.

PROVIDENT SECURITY LIFE INSURANCE COMPANY,
Respondent.

BRIEF OF RESPONDENT IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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In the Supreme Court of the United States

OCTOBER TERM, 1963

No.

JOHN S. GORSUCH, *Petitioner,*

vs.

PROVIDENT SECURITY LIFE INSURANCE COMPANY,
Respondent.

BRIEF OF RESPONDENT IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Comes now Respondent, Provident Security Life Insurance Company, and presents this brief in opposition to the Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit, filed herein by John S. Gorsuch, Petitioner.

STATEMENT

The "two separate and distinct actions for the benefit of United" filed by the petitioner were separated in time by more than three years. The derivative suit was filed by Gorsuch on November 4, 1958. The present action was filed by him on February 12, 1962, three or four days after Provident (respondent here) had sought to intervene in the first action under the mandate of the United States Court of Appeals in *Niesz v. Gorsuch* (9 CA, 1961), 295 F. 2d 909, 913.

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The present action was brought by Gorsuch as an individual stockholder of United. He argued in the District Court that his suit was not a derivative or class action of any sort. Now he seeks to change his position by the assertion that the suit was "for the benefit of United." His complaint (TR 3-5) does not so indicate in any respect, nor does it comply in any particular with Rule 23 (b), Federal Rules of Civil Procedure.

The stockholders' meeting of United held in 1959, and referred to in the petition, was not "caused" by American as the petition declares. It was called by the officers of United to consider the merger agrement of February 7, 1959 (TR 12 et seq.).

Following the merger of the two Arizona corporations—United and Provident—in the spring of 1959, 79.5% of the entire outstanding stock of United, *exclusive* of the shares voted by American for the merger, was exchanged for Provident stock under the merger agreement, and the holders thereof thereby expressly ratified and confirmed the merger. The stock held and voted by American (referred to generally in the District Court and on appeal as the "Kelly stock") was surrendered and cancelled, exactly as the merger agreement provided.

United was insolvent and its reserves substantially impaired at the time of the merger. This condition dated from the autumn of 1957, and Provident had nothing to do with it. Since the merger the policies issued by United have been assumed and continued in force by Provident, all claims have been paid, and reserves have not only been maintained but improved.

But for the merger, liquidation proceedings as to United by the Arizona Director of Insurance would have been mandatory, under Arizona law. Arizona Revised Statutes, Sec. 20-728.

Gorsuch, the petitioner here, was given full notice of the proposed merger in 1959 as a stockholder of United. He made no objection to the merger. He filed no dissent. He owned 1.5% of the outstanding stock of United, of a par value of $1,500.00. He is the only stockholder who has ever questioned the validity of the merger. The old corporation, United, is not a party to the suit, nor has any creditor of United complained of the merger.

The Arizona Director of Insurance, pursuant to the state statute (A. R. S. Sec. 20-731) concerning the merger of domestic stock insurance companies, expressly approved the merger agreement on February 26, 1959. Not only did he do this, but he actively worked toward the consummation of the merger as an alternative to liquidation of United.

The Memorandum Decision and Order which formed the basis for the summary judgment later entered (Appendix A to petition) was dated and filed on March 28, 1962. This was 44 days after the filing of the action, and 12 days after the filing of plaintiff's motion for summary judgment. The Decision expressly provided that the judgment to be entered thereon "shall not be effective for any purpose, other than as to the status of Provident, United and their shareholders in cause #2974,[1] supra, until further order of the court." This

[1] The action filed by Gorsuch on November 4 1958; twice appealed to the Court of Appeals for the Ninth Circuit (295 F. 2d 909; 323 F. 2d 826) and now before this Court on certiorari petition in No. 709.

somewhat novel restriction would appear to indicate that the judgment was designed paramountly for its strategic effect in the other action, and sheds some light on the actual purpose of the present suit.

The Court of Appeals reversed the summary judgment—and set aside the default of the defendant which for good measure had been entered by the District Court—and remanded the cause for further proceedings. The case is not closed. It is open to petitioner to pursue his efforts to nullify the 1959 merger at the trial level if he cares to do so. The opinion of the Court of Appeals (Appendix B to petition; 323 F. 2d 839) painstakingly examines each of the grounds found by the District Court to support its summary judgment that "the Merger Agreement dated February 7, 1959 * * * was and remains null and void, of no force and effect, and is hereby declared to be void ab initio" (AR 42), and concludes that it is insufficient to sustain the judgment under the facts and circumstances of the case. The opinion sets forth in footnotes the Arizona statutes discussed, as well as portions of the record.

ARGUMENT

1. *The Arizona law relative to the case was reasonably and properly construed by the Court of Appeals, and no reason exists for the issuance of a Writ of Certiorari.*

The contention of the petitioner is that the Arizona statutes regarding domestic insurance corporations and their merger have been "rewritten" by the Court of

Appeals for the Ninth Circuit, and that the Court "refused to follow" those statutes. By implication it is suggested that the District Court correctly and faithfully followed and interpreted the applicable statutory law and that its judgment on the matter is to be preferred to that of the Court of Appeals.

Petitioner has not cited a single decision of the Arizona Supreme Court which is in the slightest degree at variance with the decision of the Court of Appeals here. There is none. Only one Arizona case is mentioned in the petition, and that is *Lewis v. Stone* (1927), 32 Ariz. 182, 256 P. 1048. That decision was cited by *appellant* (respondent here) in its opening brief in connection with the effect of the failure to file a copy of the merger agreement with the County Recorder of Maricopa County, Arizona. The point made by appellant, and in regard to which the case was cited, was that Gorsuch could not complain of this oversight since he had *actual notice* of the instrument. Arizona follows the general rule that notice of an unrecorded instrument is equivalent to the recording of it, with respect to the person having such notice. *Pomeroy v. Sam Thorpe Mining Co.* (1931), 37 Ariz. 541, 553; 269 P. 255, 259. Further in this connection, the *original* merger agreement *was* filed with the Arizona Corporation Commission in Phoenix on July 27, 1959 (TR 12), as provided by law—the identical statute incidentally (A. R. S. Sec. 10-345A) which the appellee below contended was violated by the failure to file a copy with the Maricopa County Recorder, whose office also happens to be in Phoenix.

It is a strange irony that petitioner should now appear in the garb of a champion of the Arizona law.

While this case was before the District Court the defendant urged again and again, both before the judgmetn and in the post-judgment motions, that the merger had been substantially and faithfully carried out under the Arizona law; that this was clearly shown, inter alia, by the express approval of the merger by the Arizona Director of Insurance, acting pursuant to his duty under Arizona law. The District Judge gave absolutely no weight or effect to this administrative approval of the merger by the Arizona state official specifically charged by law with passing upon mergers of Arizona insurance companies (A. R. S. Sec. 20-731). He gave no consideration to the undisputed fact that the merger had been fully operative and the old corporation (United) extinct for almost three years. He chose to ignore the fact that Gorsuch, the plaintiff, had full knowledge and notice of the proposed merger in 1959 and had made no objection to it during the intervening years. The trial court gave no heed to the factual showing made in support of the post-judgment motions that the judgment, if allowed to stand, would resurrect an insolvent and impaired insurance company with disastrous effects upon the former policyholders whose policies had been assumed by Provident, as well as to its stockholders, including Gorsuch himself.[2]

The plaintiff below, of course, fully supported the trial court in all these intransigencies.

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[2] The Arizona Constitution (Art. 14, Sec. 11) imposes individual liability on the shareholders of insurance corporations for corporate debts in addition to the amount invested in stock, to the extent of the par value of stock held.

Petitioner asserts that "there is no Arizona law" supporting the opinion of the Court of Appeals. But the Arizona statutes involved—including several that petitioner does not mention—were carefully construed and followed in the light of general principles of law which there is absolutely no reason to believe would not be followed by the Arizona courts. Certainly petitioner has suggested none. If the absence of Arizona authority on the points involved is ground for granting certiorari here, then in *any* Court of Appeals case where state law is construed the issuance of a writ would follow from the simple happenstance that the state courts had not previously construed the law.

The Court of Appeals for the Ninth Circuit has not "decided an important state * * question in a way in conflict with applicable state * * law." Hence, under Rule 19 of this Court no reason appears for the granting of the writ sought by petitioner. There is no showing that the contentions made by petitioner are of interest to anyone but himself. As noted, he stands alone as the plaintiff here; no other stockholder has joined him; no creditor of United stands with him; the Arizona administrative authority charged with responsibility in respect of insurance company mergers is aligned squarely against him. The real lack of substance of his petition becomes apparent when it is remembered that the case in which he is party plaintiff is at issue now, under the mandate of the Court of Appeals, and he is at liberty to pursue it as a fully-adversarial proceeding at the trial level.

2. *The asserted "vitiation" of Arizona law governing the merger of insurance companies by the Court of Appeals is non-existent.*

Under the guise of showing how the Court of Appeals "vitiated" Arizona law the petitioner has gone over each of the four bases for the holding by the District Court that the merger was void and invalid (petition, pp. 6-9). The Court of Appeals considered these asserted grounds separately and in patient detail. Its opinion is sufficient answer to this argument, if it be considered appropriate to a request for certiorari. A few comments may be in order.

The only basis or ground set forth in the complaint for the alleged invalidity of the 1959 merger, and the only reason advanced in support of plaintiff's motion for summary judgment, was that the requisite two-thirds vote of the stock of United was not voted in favor of the merger "for the reason that 38.79% of the stock voting for the merger was unlawfully held by American Security Investment Company." (TR 4; TR 9-11). On this point the Court of Appeals held that any impropriety in the acquisition of the assets of United, which occurred in 1957, did not affect American's title to the stock, or its right to vote it. The petitioner has never suggested what alternative method of dealing with this block of stock was preferable, or how it should have been handled. It was voted and then surrendered and cancelled. It is immaterial here that "the sellers are not complaining", as petitioner asserts. Nor is it true that he is acting "in United's behalf", as he now maintains. The issue was simply whether the stock in question was properly held and voted by American. Petitioner's professed fears that the opinion will enable minority stockholders to loot a corporation and then (presumably alone) bring about a merger are groundless. Arizona law requires a two-

thirds vote of *all* outstanding stock as a prerequisite to merger.

All the other "grounds of invalidity" which found favor with the District Court were pure afterthoughts of the plaintiff below[3], having been raised subsequent to his motion for summary judgmenta. The belated assertion that the merger was invalid because all assets of United did not pass to Provident under the merger is not only in plain contradiction of the merger statute itself, it is in direct conflict with the allegations of the complaint! (para. 6, TR 3-4).

The argument that American was not the "record owner" of the stock which it voted and that therefore the vote was invalid is particularly specious. Under the Uniform Stock Transfer Act, adopted in Arizona in 1943, the endorsement of the certificates in blank and their delivery to American in 1957 was sufficient, as the Court of Appeals held. A. R. S. Sec. 10-231. Further, according to some of the materials presented by plaintiff himself in the lower court there was in fact a transfer of the stock to American on the books of United. The "notice" argument of petitioner (petition, p. 7) is hollow. Both corporations involved and all their stockholders were given advance notice of the meetings *and of the merger agreement*, which itself sepcifically refers to the stock held by American.

As for the failure to record a copy of the merger agreement in the office of the County Recorder of

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[3] Or of the District Court itself. The point that American was not the "record owner" of the stock in question was raised in an affidavit filed by plaintiff, but was not independently asserted by him prior to the court's Memorandum Decision.

Maricopa County: this has been touched upon above. The copy *was* filed before the appeal, and the filing was called to the attention of the district judge. The defect, if any, was certainly remedied before the judgment become final. To contend, as petitioner has, that the mere failure to file the copy in this particular office resulted in a total, jurisdictional failure of the merger under the circumstances of this case (which could never thereafter be cured) is to ignore reality and to magnify a formal directive out of all rational proportion.

CONCLUSION

In his peroration the petitioner insinuates that there was some unholy connection between the acquisition of United's assets in 1957 and the merger that occurred eighteen months later; that the guilty corporation, American, somehow brought about the merger to avoid liability for its wrong. He speaks picturesquely of the merger as taking place "underneath a bridge in the dark of night." In point of fact, American gained nothing by the merger, nor did it thereby escape any liability for what it had done. As petitioner himself points out (petition, p. 3) final judgment has been entered against American in the derivative action. It received nothing for the stock which it voted and then surrendered. The merger proceedings themselves were carried on in the full light of day. Notice was given to all stockholders of both corporations involved. The merger was accomplished under the supervision and with the approval of the Arizona Director of Insurance.

Gorsuch is the only individual who has entered an objection to the merger. He did not do so until 1962. He has not shown that he has been damaged by the merger—he has not even alleged it (complaint, TR 1).

The petition for a writ of certiorari should be denied.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1963

No. 717

JOHN S. GORSUCH, *Petitioner*

v.

PROVIDENT SECURITY LIFE INSURANCE COMPANY,
Respondent

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITIONER'S REPLY BRIEF

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PETITIONER'S REPLY BRIEF

The judgment of the district court herein was an integral part of the equitable relief granted by the same court and the same judge in *John S. Gorsuch and Albert J. Doig* v. *DePinto*, October Term, 1963, No.

709, Supreme Court of the United States.[1] In the latter case, District Judge George H. Boldt ordered that the $314,794.19 taken from United on October 18, 1957 by American, Francis I. Sabo, Edwin B. Pegram, Hjalmar B. Landoe, and others, due to the gross negligence of Angus J. DePinto and Elmer W. Duhame, be repaid. And having restored United's property and solvency by such order, District Judge Boldt, in this action, completed the task by giving back to United its corporate life which had also been taken from it by American and the others named above. He did so by declaring null and void the "merger"[2] which had been effected and brought about by the defendants in

[1] Petitioner first attacked the validity of the merger in March of 1959 when in *Gorsuch* v. *United* (cited on appeal as *Nicz* v. *Gorsuch*, 295 F. 2d 909) Sabo, Pegram, Landoe, DePinto, Duhame, and American sought dismissal of that action on the ground that United had been merged into Provident. However, the court of appeals ruled in October of 1961 in *Nicz* v. *Gorsuch*, 295 F. 2d 909, that Gorsuch was estopped from so attacking the merger therein and must do so in a direct action. This action then followed.

[2] Paragraph 6 of the merger agreement states that United shareholders received 1 share of Provident stock for each 30 shares of United stock plus a Participating Unit in United. Since the United shareholders had paid $150 for these 30 shares and the Participating Unit and the Provident stock, according to the merger agreement, was worth $1.70 per share, the "merger" effected by American, Sabo, Duhame, Pegram, and Landoe gave the United shareholders $1.70 for each $150 invested. Provident in exchange for $4,080 of its stock (61,200.11 shares divided by 30 equals 2,400 times $1.70 or $4,080) received about $29,000,000 in life insurance and annuities in force. Valued conservatively at $20 per $1,000, Provident obtained, as a result of the 38,799.89 shares of United Stock "voted" by American, seasoned life insurance worth $600,000 for $4,080, while at the same time limiting its assumption of liabilities of United. (R. 14, 16, 17-19). During oral argument below Provident refused to state that it assumed all of the liabilities of United as required by Arizona statute.

Gorsuch v. *DePinto*, *supra*, American, Sabo, Pegram, Landoe, Duhame, and others. Thus, Respondent is correct, in suggesting at page 4 of its brief, that the instant action is related to *Gorsuch* v. *DePinto*, *supra*.

Because of this relationship, and the issues raised in the Petition,[3] the Court should either grant review now or defer its decision until it decides whether to review the court of appeals' decision in *Gorsuch* v. *DePinto*, *supra*, as to whether the parties in a stockholder's derivative action are entitled to a Seventh Amendment jury trial and whether Rule 50 (b) forbids a judgment n.o.v. in excess of a jury verdict. The reason is that if the Court should review *Gorsuch* v. *DePinto*, *supra*, and subsequently reverse the court of appeals, an extremely important aspect of the relief sought for United will have been foreclosed should the Court deny the Petition here at this time.[4]

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[3] Respondent's brief in opposition contains so many unsupported and erroneous mixed "factual" and "legal" propositions that a 30 or 40 page reply would be required. It is significant, however, that it did not respond to the several challenges to the rationale of the court of appeals' opinion, preferring instead to make factual and legal contentions without the citation of authority. Typical of these is the claim that Arizona's Director of Insurance "approved" the merger. He did not. All he approved was the merger *agreement* which was submitted to him before the vote occurred. Nothing in the record shows that he knew that American, Sabo, Pegram, Landoe, and others had taken $314,794.19 of United's assets to "pay" for the United stock (38,799.89 shares) which they purported to vote in favor of the merger after they had been sued for the return of the $314,794.19.

[4] Respondent's statement that Petitioner may proceed with a trial on the merits is beside the point since the court of appeals, in its decision here, has foreclosed the four bases of attack on the validity of the merger brought about with the 38,799.89 shares of United stock "paid for" by American, Sabo, Pegram, and Landoe.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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with the $314,794.19 of United's cash, bonds, and mortgages. (That President was aware of the illegality of the 38,799.89 shares of United stock held by American is shown in paragraph 8 (e) of the merger agreement which requires the cancellation of these shares without consideration to American. In short, President relies on the subsequent votes of these same 38,799.89 shares to validate the merger)... (R. 18).